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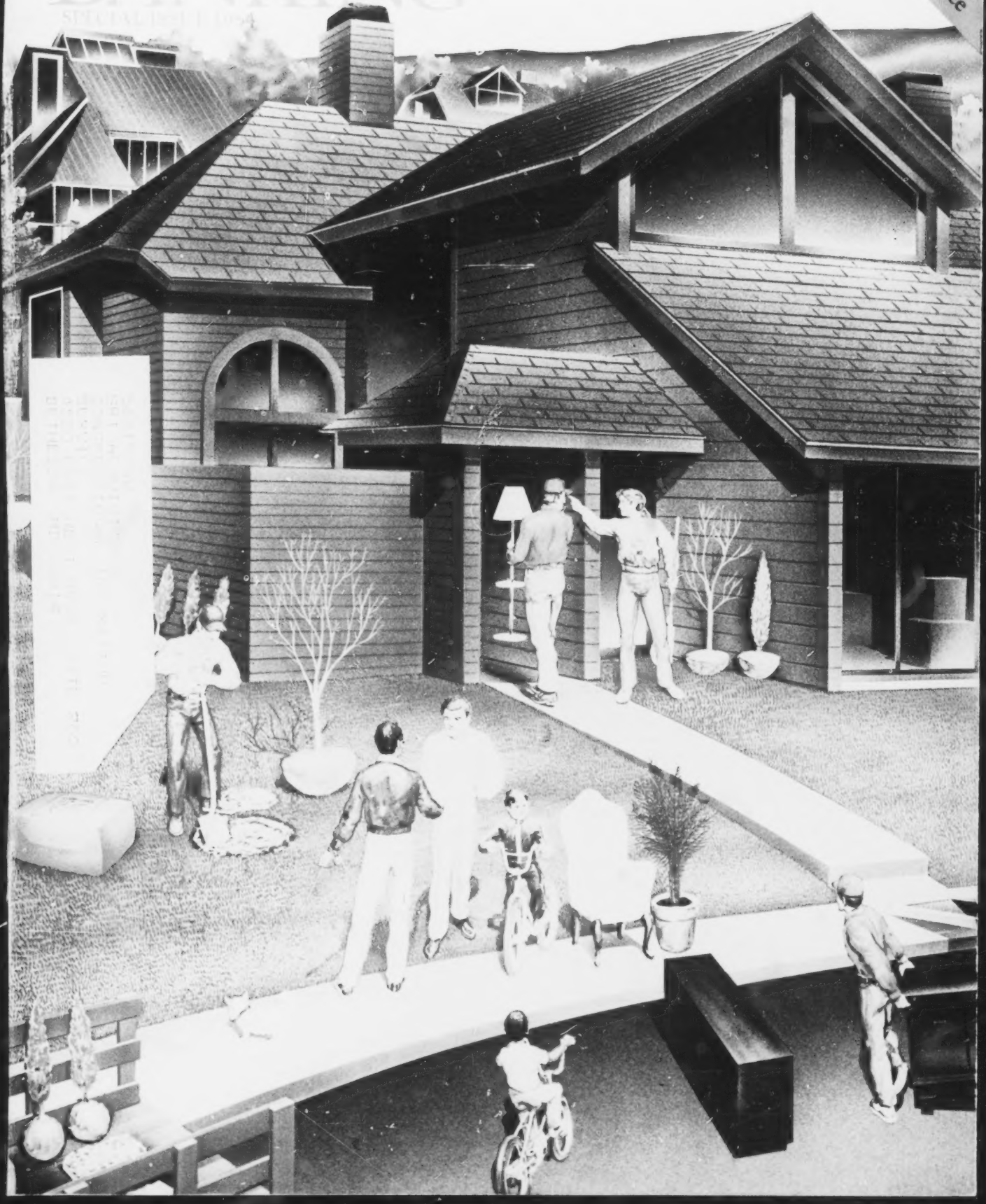
MORTGAGE BANKING

The Magazine of Real Estate Finance



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CMOs AND HOW THEY GREW

During the past several months, the mortgage market has taken several giant steps toward strengthening its ties to the overall capital bond market. The reason: the introduction of a new mortgage-backed security known as a collateralized mortgage obligation (CMO). According to observers, successful reception of CMOs indicates the potential of such a security to revolutionize the sources of and methods by which funds are raised to finance housing.

"Successful reception of CMOs to date indicates the potential of such a security to revolutionize the sources of and methods by which funds are raised to finance housing."

Richard M. Hamecs

General characteristics

A collateralized mortgage obligation is a debt obligation of the issuer, which is created solely for the purpose of selling the bond. As its name implies, the obligation may be backed by whole mortgage loans. More typically, however, CMOs sold over the past several months were collateralized by mortgage-backed pass-through securities (MBSs), which were guaranteed by the Government National Mortgage Association (GNMA), the Federal Home Loan Mortgage Corporation (FHLMC) or the Federal National Mortgage Association (FNMA).

Of the nearly $10 billion of CMOs issued, 57 percent were backed by GNMA mortgage-backed securities; 27 percent by conventional loans (virtually all of which were issued by the FHLMC); and 16 percent were collateralized by a mixture of Federal Housing Administration (FHA), Veteran's Administration (VA), and conventional whole mortgage loans.

CMOs are structured into multiple classes, each bearing a different stated maturity. The maturity of each class is based on an expected pattern of pay-off to the pool of underlying mortgage loans. The majority of CMOs sold over the past several months, for example, were comprised of at least three, and more often four different classes.

The multiple class/maturity structure of a CMO issue produces a unique pattern of cash flow that clearly distinguishes it from most other mortgage-related investments. In essence, a CMO is a hybrid between standard mortgage-backed bonds (MBBs) that were sold during the past decade and mortgage-backed pass- through securities (MBSs). Similar to a bond, interest is paid semiannually to the CMO investor. However, unlike a standard mortgage-backed bond, a CMO provides for the modified "pass-through" of principal to the bond-holders. While this feature is similar to an MBS, principal is only passed through to a CMO investor in semiannual installments, in contrast to monthly payment in the case of an MBS.

CMOs have been particularly attractive to some investors, who might not otherwise invest in the mortgage market, because they provide a modified form of "call-protection." Although the investment community and housing industry have long desired a mortgage instrument that offered "call-protection," attempts to design such an instrument proved futile in the past. A CMO successfully achieves this goal through a *de facto* breakdown of the underlying pool of mortgages according to how quickly the loans are repaid.

This fast-pay/slow-pay feature is reflected in the sequential retirement of

continued

[1]Treasury yields are based on average constant-maturity, comparable-term bonds for the week of the financing. Spreads may therefore differ slightly from the actual pricings at time of sale. These Treasury bond yields are used in order to ensure consistency between the comparisons.

Table 1

Monthly Volume of CMOs Sold
(dollar amounts in millions)

Month	Number	Amount
1983		
June	1	$1,000.0
July	1	113.5
August	–	–
September	2	1,184.7
October	4	614.6
November	3	1,300.1
December	1	447.2
1984		
January	8	2,237.0
February	7	2,700.2
Total	27	9,597.3

Sources: Data Securities Incorporated, Moody's "Bond Survey," and Telerate

the classes comprising a CMO issue. Monthly payment of principal received by the issuer from the pool of underlying mortgages (including scheduled amortization or early payoffs) is first returned to investors who hold the shortest maturity class. Only after the first class is retired can investors who have purchased the longer-term class expect to receive any "pass-through" principal.

This sequential payment design benefits both the issuer and the investor. For investors, sequential payment lends greater certainty to the term of their investment by partially guarding against much faster than desired return of principal—a form of call protection. For issuers, the temporary retention of principal and interest received monthly from the pool of underlying mortgages is a source of income during the holding period before subsequent semi-annual disbursements are made to CMO investors.

Stated maturities for classes of CMOs sold during the past several months have ranged between three and 30 years. However, actual maturity of a class is likely to be substantially shorter because of prepayments of the underlying mortgages. Therefore, to an investor considering purchasing a CMO, two maturity dates are important. First, there is the stated maturity, i.e., the date when the class is to be redeemed without prepayments. Second, there is the average weighted life, i.e., the estimated life of the class with prepayments. Calculations of the "weighted average life" (WAL) are based on the historical pattern of the FHA loan payoffs. WALs are extremely important in pricing CMOs.

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Distinctions

CMOs are distinct in at least two respects from standard, single-maturity MBBs sold during the past decade. First, the face amount of a CMO tends to be much larger than a MBB. During the past eight months, the average issue size of a CMO sold was over $359 million—more than 20 times larger than the average size of a standard mortgage-backed bond of just under $15 million. Because of the high up-front costs of setting-up a CMO, the optimum issue size is generally considered to be between $250 and $500 million.

Second, CMOs are seldom as overcollateralized as straight MBBs. In some instances, the dollar amount of mortgages needed to back a straight mortgage-backed bond could go as high as 175 percent of the face amount of the bond. Substantial overcollateralization of an MBB was often deemed necessary to guard against potential shortfalls. Obviously, this practice has a serious drawback in that it locks up the pool of underlying mortgages for as long as the bond is outstanding. Despite this impediment, however, nearly $1 billion of standard mortgage-backed bonds were sold during 1983.

A feature shared by CMOs and traditional mortgage-backed bonds is that both are considered to be a debt financing of the issuing company, although this treatment is still open to debate. Specifically, the question is: should the sale of a CMO be treated as a sale of assets (i.e., mortgage and mortgage-backed securities collateralizing the bond) or a debt financing? For federal tax purposes, CMOs have been treated as debt financing because there is no "active" management of the underlying pool of loans. Federal taxes are paid by the CMO investor and not by the CMO issuer, even though the monthly receipt of principal and interest payments from the collateralized mortgages are reinvested prior to disbursement.

To date, however, the Financial Accounting Standards Board (the standards-setting arm of the accounting profession) has yet to establish guidelines for what the appropriate accounting treatment should be for CMOs. Although there is no consensus, some accountants view CMOs as constituting a sale of assets, despite the tax treatment afforded on these transactions. However, other members of the profession agree with the Treasury's view that CMOs are a debt financing of the issuing entity.

Volume of activity

The capital market was introduced to this newest mortgage-backed security in June 1983, with a sale of a $1 billion issue by the FHLMC. Collateralized by conventional loans and FHLMC Participation Certificates (PCs), this offering was divided into three classes in amounts of $215, $350, and $435 million. The WALs were 3.2, 8.6, and 20.4 years, respectively, for the three classes. The FHLMC offering met with resounding success. Yields for the three classes were only 43, 60, and 87 basis points higher than comparable-term Treasury securities—a spread considerably less than the 250-300 basis points that historically separated FHLMC PC and comparable-term Treasury bond yields.

As shown in Table 1, the CMO concept caught on quickly. By the end of 1983, 12 CMO issues were sold totalling nearly $5 billion—most backed by GNMA MBSs (the exception was the FHLMC CMO). During January and February of 1984, CMO sales brought the

continued

cumulative totals to 27 issues totalling nea.'x $10 billion.

Several recent CMO offerings that have expanded the initial concept or are of particular importance include:

- Prudential Realty Surety Inc., which sold a $271 million CMO on January 27, 1984 backed by seasoned mortgage loans bearing interest rates as low as 4 percent.
- A $352 million CMO backed only by conventional Norwest mortgage-backed securities that was sold by Norwest Mortgage on February 2, 1984.
- The largest CMO, totalling $1,250 million, which was sold by Travelers Mortgage, Inc., on February 23, 1984.

Issuers

Sixteen institutions have been responsible for the 27 CMO financings since June 1983. The issuers have included subsidiaries of Lomas & Nettleton Mortgage Company (L&N Funding Corp.), two New York investment houses (Salomon Brothers and Paine Webber), and several insurance companies, including Travelers and Prudential. Other categories of issuers included mortgage insurance and conduit corporations, individual and consorted home building concerns, and a unit investment trust. (See Table 2.)

The largest institutional issuer of CMOs has been the FHLMC with three offerings totalling $2.2 billion or slightly more than 20 percent of all CMO offerings. Also in the $1 billion-plus category are Investors GNMA Mortgage-Backed Securities Trust, Inc. (two issues totaling $1.1 billion) and Travelers Mortgage (one issue for $1.25 billion).

Buyers

A recent report by Salomon Brothers, Inc. sheds important light on the types of investors who have been the major buyers of CMOs. Salomon Brothers' data also indicate the maturity classes that these buyers found most attractive. As shown in Table 3, pension funds have been extremely active buyers of all CMO maturity classes.

Table 2

Issuers of Collateralized Mortgage Obligations
July 1983–February 1984
(dollar amounts in millions)

Issuers	CMOs Issues Number	Amount
	#	$
Federal Home Loan Mortgage Corporation	3	2,209.7
Travelers Mortgage Securities, Inc.	1	1,250.0
Investors GNMA Mtge-Backed Securities Trust, Inc.	2	1,000.0
Guaranteed Mortgage, Inc.	4	968.5
Norwest Mortgage Insured, Inc.	3	963.4
Paine Webber Programmed Amor. Term Sec., Inc.	1	500.0
Salomon Brothers Mortgage Securities, Inc.	1	500.0
Sears Mortgage Securities Corp.	1	500.0
American Southwest Financial Corporation, Inc.	3	325.5
Pulte Home Credit Corporation, Inc.	1	300.0
Centrex Acceptance Corporation	2	300.0
Prudential Realty Securities, Inc.	1	271.5
L&N Funding Corporation	1	250.0
Ryan Mortgage Acceptance Corp.	1	151.1
International Mortgage Acceptance Corp.	1	107.3
	27	9,597.3

Sources: Data Securities Incorporated, Moody's "Bond Survey," and Telerate

Table 3

Major Institutional Groups Buying CMOs
(Percent Distribution)

Maturity Class (Weighted Average Life)	Thrift Institutions %	Banks %	Insurance Companies %	Pension Funds %	Other %
Class 1 (WAL 2 to 3.2 yrs)	26.9	17.7	18.1	33.2	4.1
Class 2 (WAL 4 to 6.1 yrs)	7.2	2.1	57.4	29.1	4.2
Class 3 (WAL 8 to 11.1 yrs)	5.5	3.4	40.4	48.7	2.0
Class 4 (WAL 17 to 22.3 yrs)	3.3	—	29.3	67.4	—

Notes: "Other" includes security dealers, federal agencies, foundations, and corporate and municipal operating funds.
"Maturity Class" is measured by the weighted average life (WAL) of the obligation.

Source: Salomon Brothers, Inc., "Comments on Credit," March 9, 1984

Pension funds accounted for 33 percent of Class 1 or A obligations (WAL less than four years); 29 percent of Class 2 or B bonds (WAL 4.1 to seven years); nearly half of Class 3 or C bonds (WAL of 7.1 to 10 years), and over two-thirds of the longest maturity Class 4 or Z bonds (WAL in excess of 10 years). The second major CMO investor group was insurance companies, although this group tended to focus its purchases in the mid-range classes.

To the extent thrift institutions and banks were attracted to CMOs, their investments were limited to the shortest maturity class with a WAL of less than four years. Combined, the thrifts and banks have purchased approximately 45 percent of the Class 1 or A obligations.

Pricing and yields

The Norwest Mortgage Conventional I is among five representative CMOs for which detailed pricing and yield spread information is provided in Table 4. As shown in this table, pricings on CMOs were extremely favorable relative to comparable-term Treasury securities. The result was a fairly narrow yield spread between CMOs and Treasur-

Table 4

Recent Sales of Serialized Mortgage-Backed and Mortgage Collateralized Bonds

Sales Date	Issuer	Ratings Moodys	Ratings S&P	Amount (millions)	Stated Maturity	Weighted Ave. Life[1]	Coupon Rate %	Price %	Yield %	Comparable Yield %	Treasury Pricing[2] Term (years)	Treasury Pricing[2] Spread %
1/19/84	The Federal Home Loan Mortgage Corporation											
	10.75% PC-Coll Bonds	NR	NR	129.625	1/31/87	1.8	10.75	99.9688	10.77	10.54	18 mo	23
	11.35% PC-Coll Bonds	NR	NR	86.450	1/31/89	4.3	11.35	100.00	11.35	11.19	4 yr	16
	11.875% PC-Coll Bonds	NR	NR	228.725	1/31/94	7.8	11.875	100.00	11.875	11.73	7 yr	15
	12.10% PC-Coll Bonds	NR	NR	80.200	1/31/09	16.8	12.10	95.125	12.467	11.78	15 yr	69
				525.000								
2/2/84	Norwest Mortgage Conventional 1, Inc.											
	11% Coll Mtge Bonds, Class A	Aa2	AA	55.000	2/1/91	2.3	11.00	100.00	11.00	10.59	2 yr	41
	12% Coll Mtge Bonds, Class B	Aa2	AA	105.000	2/1/97	5.4	12.00	99.75	12.066	11.33	5 yr	74
	12.5% Coll Mtge Bonds, Class C	Aa2	AA	157.200	2/1/02	10.1	12.50	99.72	12.566	11.62	10 yr	95
	12.5% Coll Mtge Bonds, Class Z	Aa2	AA	35.000	2/1/14	20.8	12.50	91.625	13.041	11.71	20 yr	130
				352.200								
2/3/84	American Southwest Finance											
	10.875% GNMA Coll Bonds	NR	AAA	10.110	8/1/91	2.1	10.875	99.813	10.969	10.59	2 yr	37
	11.875% GNMA Coll Bonds	NR	AAA	22.100	2/1/96	5.1	11.875	99.313	12.046	11.33	5 yr	71
	12.375% GNMA Coll Bonds	NR	AAA	36.375	2/1/01	9.6	12.375	99.188	12.517	11.62	10 yr	90
	12.375% GNMA Coll Bonds	NR	AAA	7.915	2/1/14	20.0	12.375	90.75	12.95	11.71	20 yr	124
				76.500								
2/14/84	L & N Funding Corporation											
	11% GNMA-Coll Bonds, Series A1		AAA	68.000	9/17/90	2.41	11.00	99.975	11.12	10.76	2 yr	36
	11.875% GNMA-Coll Bonds, Series A2		AAA	72.000	3/17/94	5.44	11.875	99.46	12.01	11.54	5 yr	47
	12% GNMA-Coll Bonds, Series A3		AAA	58.000	3/17/96	7.83	12.00	98.50	12.34	11.74	7 yr	60
	12% GNMA-Coll Bonds, Series A4		AAA	52.000	3/17/14	17.99	12.00	87.43	13.05	12.00	20 yr	105
				250.000								
2/22/84	Norwest Mortgage Insured, Inc.											
	11.25% GNMA-Coll Bonds, Series A	Aaa	AAA	23.200	4/1/91	2.00	11.25	99.844	11.334	10.93	2 yr	40
	12.25% GNMA-Coll Bonds, Series B	Aaa	AAA	39.300	10/1/96	4.81	12.25	100.00	12.25	11.67	5 yr	58
	12.25% GNMA-Coll Bonds, Series C	Aaa	AAA	86.520	10/1/02	9.71	12.25	97.625	12.665	11.95	10 yr	71
	12.25% GNMA-Coll Bonds, Series Z	Aaa	AAA	15.000	4/1/14	21.34	12.25	85.50	13.136	12.09	20 yr	105
				164.020								

[1] Weighted average life of underlying pool, assuming 100 percent of FHA experience.

[2] Yield comparison approximated, using average constant-maturity Treasury yields for the week of financing. These yields may not equal new or secondary market Treasury security yields at time of CMO sale.

ies—in one case as low as 15 basis points.[1]

The width of the spread, however, varied according to maturity, issuer, and type of collateral. Usually, differentials tended to be smaller on shorter maturities than for longer maturities. Of the five issues reviewed, the short maturities sold at yields between 23 and 41 basis points above comparable-term Treasuries. The spread for the long maturities was between 69 and 130 basis points.

These differences are suggested by two factors: 1) the type of security collateralizing the issue (FHA/VA loans in a GNMA-guaranteed MBS, or conventional mortgages) and 2) who was doing the financing (a federally sponsored agency—(FHLMC), or a private conduit—(Norwest). The smallest spread on the long maturity (69 basis points) was on the FHLMC offering. In contrast, the Norwest Conventional I issue, backed solely by conventional mortgages, required the largest yield markup relative to Treasuries—130 basis points. The spread for another Norwest offering that was backed by GNMA-guaranteed MBSs was 25 basis points lower, or 105 basis points above a comparable-term Treasury bond yield.

continued

Table 5

Spreads Between Treasury, GNMA, AAA-Corporate, and AAA-Utility Yields January 1982 to February 1984

Period	Yield Differentials GNMA— Trea	GNMA BE*— Trea	Corp— Trea	Util— Trea	Spread Diff GNMA BE— Utility
82:1	1.68	2.22	0.87	1.31	.91
82:2	1.60	2.11	0.80	1.24	.87
82:3	1.38	1.82	0.84	1.16	.66
82:4	1.35	1.66	1.04	1.45	.21
83:1	1.29	1.60	0.99	1.46	.14
83:2	1.19	1.48	0.77	1.28	.20
83:3	1.21	1.56	0.56	1.08	.48
83:4	0.85	1.18	0.53	0.95	.23
1982–1983 Average	1.32	1.71	0.80	1.24	0.47
1983					
January	1.36	1.71	1.02	1.52	.19
February	1.23	1.53	1.00	1.46	.07
March	1.28	1.57	.94	1.41	.16
April	1.32	1.61	.88	1.37	.24
May	1.11	1.39	.79	1.34	.05
June	1.15	1.45	.64	1.13	.32
July	1.26	1.60	.56	1.10	.50
August	1.25	1.61	.57	1.10	.51
September	1.13	1.47	.56	1.04	.43
October	1.02	1.35	.50	.91	.44
November	.83	1.16	.52	.93	.23
December	.71	1.04	.57	1.00	.04
1984					
January	.68	0.95	.39	1.04	–.09
February	.54	0.82			.82

* Bond Equivalent Yield

Source: Data Resources Incorporated

Importance of yield spreads

Yield relationships are important to CMOs. Indeed, the impetus for the rapid growth of these securities over the past eight months has been the favorable arbitrage position available to CMO issuers. A CMO can work only if the interest income from the underlying collateral (plus any re-investment interest income from temporarily retained principal) is greater than the interest rates the issuer must pay to the investor who buys the security.

While other debt instruments can be used for CMO-like transactions, mortgages and mortgage-backed securities are ready candidates for the task for the following reasons. First, in order to enhance the attractiveness of the CMO, an ample and expanding supply of collateral is necessary to assure the liquidity of the security.

Second, the collateral to back the issue must be considered sufficiently "safe" and have a predictable, if not certain, pattern of cash flow.

Third, and most important, the interest income derived from the underlying collateral must be sufficient to provide a return to both issuer and investor. In short, the collateral must yield more than Treasuries but not so much that the issuer's cost of acquiring the collateral is prohibitive.

Mortgages, and especially mortgage-backed securities, easily satisfy each of these requirements, particularly the last. Historically, the differential between yields on mortgages and mortgage-related securities and Treasury securities has remained fairly stable and of sufficient breadth to assure a return to both issuer and investor.

Effects on the secondary mortgage market

Based on available evidence, the popularity of CMOs accelerated the demand for mortgages and other mortgage-related securities during a period when no commensurate rise occurred in the supply of mortgage product in the secondary market. Conflicting forces of rising demand and stable-to-moderately-declining supply sharply compressed yields on mortgages relative to all other types of debt instruments.

A review of historic and current yield spreads illustrates the effects of CMOs on pricing in the mortgage market. While the following yield spread analysis focuses on GNMA guaranteed mortgage-backed securities (and correspondingly the FHA and VA loan market) similar trends also are found with regard to conventional mortgages.

GNMA and Treasury yield spreads

Monthly data comparing yields for "current" coupon GNMAs and 10-year Treasuries are presented in Table 5, spanning the period from January 1982 to February 1984. More detailed weekly data are presented in Table 6. (While both nominal and bond-equivalent yields for GNMAs are shown in these tables, the following discussion pertains only to the GNMA bond equivalent yields). Throughout this period, GNMAs typically traded at yields around 175 basis points (1.75 percentage points) above 10-year Treasuries—a level that is generally considered "normal" from an historical perspective. Fluctuations around this "norm" abound, however. Until October 1983, the spread ranged from a monthly average high of 236 basis points (February 1982) to a low of 139 basis points (May 1983).

Initial signs of a compression in the GNMA and Treasury yield spread appeared in October 1983, when the differential narrowed to 135 basis points. During November and December, the respective yields continued, converging to a low of 104 basis points in December. The spread continued declining during the first two months of 1984 to a record low 78 basis points during the last week of February.

None of the historical reasons for fluctuating yield spreads appears adequate to explain the magnitude or duration of the recent GNMA and Treasury yield compression. On the contrary, the current and ongoing narrow spread between GNMA and Treasury yields sug-

Table 6

Comparisons of Treasury, GNMA, AAA-Corporate, and AAA-Utility Yields July 1, 1983 to February 24, 1984

Week Ending		Yield Differentials GNMA—Trea	GNMA BE*—Trea	Corp—Trea	Util—Trea	Spread Diff GNMA BE—Utility
1983						
Jul	1	1.25	1.56	0.59	1.09	.47
	8	1.28	1.61	0.52	1.07	.54
	15	1.24	1.58	0.52	1.06	.52
	22	1.23	1.56	0.63	1.15	.41
	29	1.28	1.63	0.54	1.09	.54
Aug	5	1.33	1.70	0.54	1.09	.61
	12	1.28	1.66	0.57	1.12	.54
	19	1.29	1.65	0.62	1.13	.52
	26	1.16	1.50	0.64	1.10	.40
Sept	2	1.11	1.47	0.49	1.07	.40
	9	1.06	1.41	0.57	1.05	.36
	16	1.17	1.52	0.55	1.07	.45
	23	1.12	1.46	0.56	1.02	.44
	30	1.19	1.53	0.58	1.02	.51
Oct	7	1.19	1.52	0.62	1.03	.49
	14	1.04	1.38	0.39	0.81	.57
	21	1.02	1.35	0.52	0.88	.47
	28	0.84	1.17	0.46	0.89	.28
Nov	4	0.83	1.16	0.46	0.92	.24
	11	0.78	1.11	0.49	0.89	.22
	18	0.81	1.14	0.51	0.93	.21
	25	0.88	1.21	0.56	0.94	.27
Dec	2	0.78	1.10	0.57	0.96	.14
	9	0.68	1.01	0.51	0.97	.04
	16	0.66	0.99	0.58	1.05	–.06
	23	0.76	1.09	0.61	1.01	.08
	30	0.70	1.03	0.62	1.00	.03
1984						
Jan	6	0.67	1.00	0.56	0.97	.03
	13	0.67	0.99	0.60	0.98	.01
	20	0.72	1.04	0.30	0.94	.10
	27	0.63	0.95	0.24	0.95	–
Feb	3	0.58	0.87	0.19	0.93	–.06
	10	0.59	0.91	0.08	0.82	.09
	17	0.51	0.83	0.06	0.73	.10
	24	0.48	0.78	0.13	0.77	.01

* Bond Equivalent Yield

Source: Data Resources Incorporated

gests that CMOs have caused a more fundamental shift in the basic yield structure. Supporting this is the analysis that follows on the relationship of yields between GNMA and AAA-rated utility bonds. What is not known at this point is how long these present patterns will persist.

Utility bond yield spreads

A steady convergence of yields between GNMAs and other debt instruments has occurred over the past several months. This is indicated by the yield differential between maturity-comparable GNMA and AAA-rated utility bond yields shown in Tables 5 and 6. (This analysis was limited to AAA-rated utility bond yields. AAA-rated corporate yield indices have been heavily influenced by recent CMOs sales, because these indices tend to be based on recently sold issues. The vast majority of these have been AAA-rated CMOs that are considered corporate bonds.)

Maturity-comparable yield spreads are calculated as the difference between GNMA versus 10-year Treasury yields and 20-year AAA-rated utility versus 20-year Treasury bond yields. The purpose of this calculation is to minimize yield curve effects. By this measure, the current prevailing yields on GNMAs are virtually equal to AAA-rated utility bond rates.

The disappearing differential is most unusual. During the past two years, the average spread was 47 basis points, with GNMAs consistently trading at higher yields than AAA-rated utilities. In early 1982, the difference was nearly one full percentage point. Since October 1983, however, when CMOs became the "hot" debt instrument, the differential consistently declined. The average differential for January and February 1984 was less than four basis points.

CMOs and home mortgage interest rates

Among the beneficiaries of this phenomenon were homebuyers. As Table 2 illustrates, the lower secondary mortgage market yields (resulting from the convergence of GNMA-Treasury yields) were passed along to homebuyers in the form of lower home mortgage interest rates. The data in this table reflect the same convergence of yields between Treasuries and GNMA-guaranteed securities discussed above.

In January 1983, a homebuyer with an FHA loan would have paid an effective interest rate of approximately three percentage points more than the prevailing 10.43 percent yield on 10-year Treasuries, i.e., an effective FHA loan rate of around 13.5 percent. During the final week of February 1984, the same loan would have cost only one percentage point more than the 11.95 percent 10-year Treasury security rate, i.e., an FHA loan rate of about 13 percent. Although yields on 10-year Treasuries are now 1.5 percentage points more than in 1983, effective interest rates for FHA-insured mortgages in February 1984 (13.04 percent) were less than .5 percent higher than they were in January 1983 (12.61 percent). □